



# THE MORNING ENERGY UPDATE

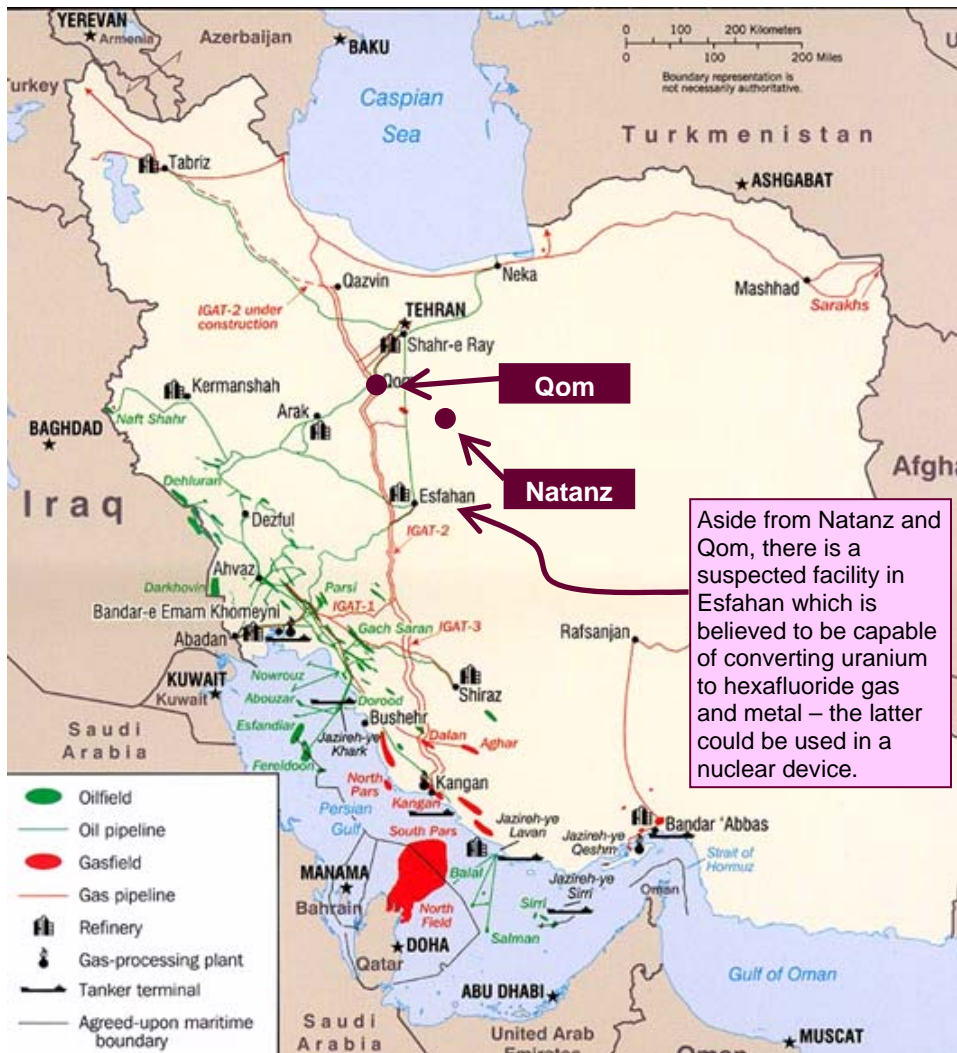
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## THE 10 DAYS OF DAWN

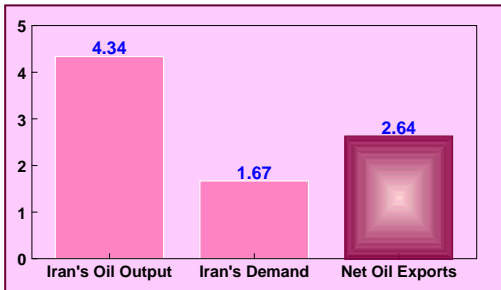
Next month marks the 31<sup>st</sup> anniversary of the Iranian revolution (which in Tehran has been eulogized using the above title). February also marks the semi-annual review by the International Atomic Energy Association’s of the Iran nuke issue. Beginning about 6 years ago, the Iranian program started generating periodic anxiety in the oil markets. Last year’s disclosure that the country housed a secret uranium enrichment facility in Qom fostered concerns that there would be a military strike by either the US or Israel, even with Tehran’s expressed willingness to allow an inspection of the facility.



There are a few key points we’ll highlight today starting with the fact that Natanz and Qom are both located away from key oil production & processing centers. Natanz houses advanced design centrifuges that can produce “yellow cake” (which is weapons grade uranium). The initial reports about Natanz surfaced in ‘02. At that time, *Jane’s Defense Weekly* predicted that Israel would target and destroy the facilities by the start of 2004. At some point, we agree that a military strike against these facilities becomes probabilistic since Iran’s intent is to produce a weapon (which is supported by the general population). Nevertheless, at this time we have no indication that Iran crossed the “tipping point” in being able to produce the bomb.

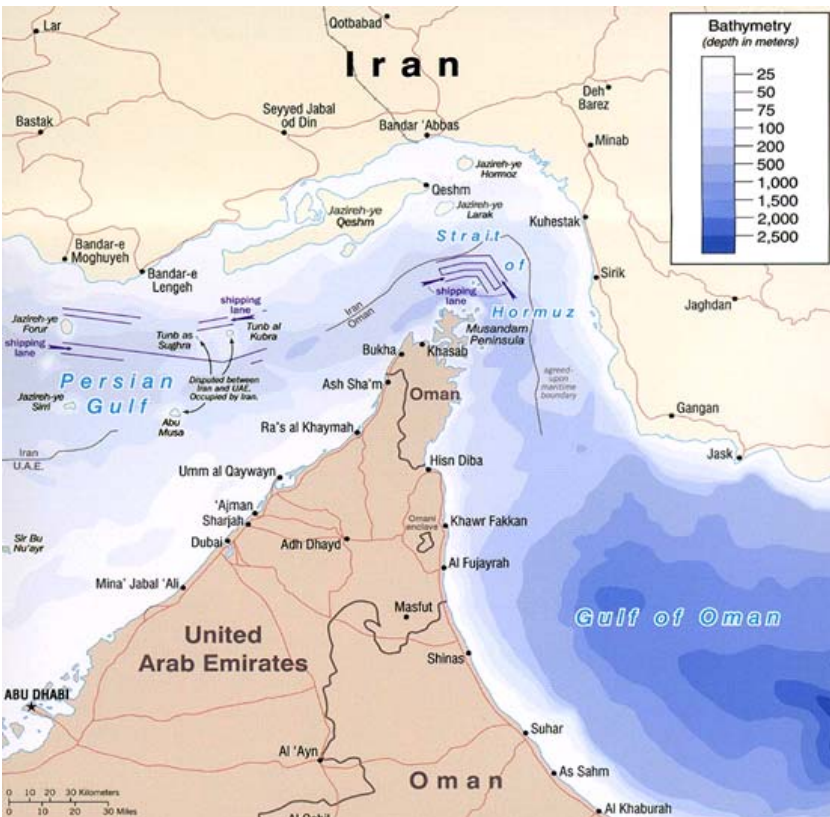
If we work on the assumption that there eventually will be military action taken to destroy Iran's nuclear bomb facilities, there are 3 questions that will become critical to the oil market on the 1<sup>st</sup> day of the attacks which, we think, will be **(1)** Do the strikes pose a threat to the country's oil production & export infrastructure? **(2)** Will Iran retaliate by halting its oil exports? **(3)** Will Iran retaliate by interrupting oil tanker traffic through the Straits of Hormuz?

We believe the answer to question #1 is "no." Both Natanz and Qom are located away from key oil facilities, so the risk of damage from military strikes seems close to nil. We would also assume that any such strikes (whether from Israel or the US) would be "surgical" in nature making the risk of any oil facility damage quite small.



With respect to question #2, Iran oil exports continue to be the lifeblood of its economy. The country's earnings have been "strained" already with the drop in crude prices from the Summer '08 peak and the threat of halting exports seems hollow given OPEC's 5.2 MM b/d of spare capacity.

Question #3 is the one we expect to generate the most market angst. There are about 19.5 MM b/d of crude and liquids transiting through the Straits of Hormuz (detailed below). Iran's made periodic threats about halting traffic for the better part of 30 years. While we claim no military expertise, data from private sources that we consider reliable suggest Iran does not have the military platforms nor the weapon systems to pose shipping threats through the Straits.



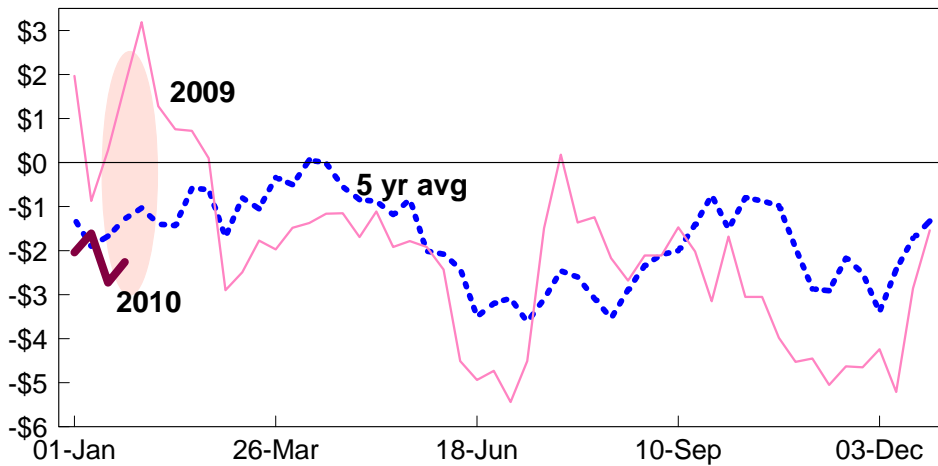
Even if we assume Iran were able to sink an oil tanker in the Straits, keep in mind that there is nearly 25 miles of shipping lanes available for VLCCs to move crude and liquids – i.e. you'd simply sail around a problem. For all these reasons, our view continues to be that that the Iran nuke issue poses headline risk *as opposed to* a genuine supply risk.

Average Daily Exports (million barrels/day)	
Iran	2.569
Iraq	1.759
Kuwait	2.464
Qatar	1.308
Saudi Arabia	8.469
UAE	2.646
Bahrain	0.162
<b>Total</b>	<b>19.376</b>

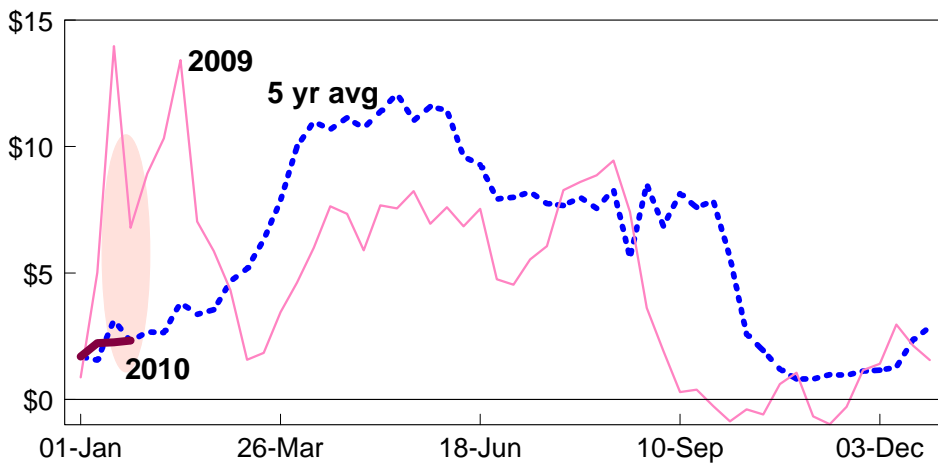


# CASH MARKET REFINING MARGINS ARE LACKLUSTER

**Singapore Refining Margins**  
Our model for weekly levels, \$/barrel



**Our Model for Average Gross US Refining Margins**  
Weekly level, \$/barrel



**European Refining Margins**  
Our model for weekly levels, \$/barrel



Cash market refining margins in key centers continue to look weak. All are materially below year-ago levels with the Far East figures also staying below the 5 year average.

Like tanker rates and the industrial fuel cracks, we gauge refining margins as means of assessing oil demand – specifically how much pressure regional capacity is facing to meet end user needs. Currently, the only close-to-real-time barometer we publish giving us a “+” reading is cash market tanker rates – which we discussed in yesterday’s report.

